Liberty High School

AP Macroeconomics

Mr. Lopez

Chapter one

Principles of Economics

And

Thinking Like an Economist

Study Guide

(73 points)

Name:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Period:\_\_\_\_\_

Part 1 - Key Terms & Review:

1. Economics:
2. Basic Economic Truth:
3. Needs:
4. Universal versus non-universal needs:
5. Wants:
6. Products:
7. Goods:
8. Services:
9. Businesses:
10. Households:
11. Scarcity:
12. Shortage:
13. Tradeoffs
14. Opportunity cost:
15. Institutions:
16. Incentives:
17. Market economy:
18. Invisible hand:
19. Business cycle:
20. Rational:
21. Thinking at the margin:
22. Marginal change:
23. Marginal benefit:
24. Marginal cost:
25. Net marginal benefit:
26. Inflation:
27. Deflation:
28. Capitalism:
29. Socialism:
30. Property Rights:
31. Free transaction:
32. Rule of Law:
33. Entrepreneurship:
34. Efficiency:
35. Externality:
36. Positive versus negative externality:
37. Sunk cost:
38. Physical capital:
39. Human capital:

Part 2 - Problems and Short Answer Questions:

1. People respond to incentives. Governments can alter incentives and, hence behavior with public policy. However, sometimes public policy generates unintended consequences by producing results that were not anticipated. For each of the following, public policies, determine which result was likely the intended result and which was the unintended consequence.
   1. The government raises minimum wage to $15.00 an hour. Some workers find jobs at the higher wage and current workers are better off. Several business reduce the size of their workforce sometimes replacing workers with automation or more productive equipment and other businesses pass along the higher cost of workers by increasing their prices.
   2. The government places rent control on apartments restricting rent to $300 per month. Fewer landlords are willing to increase the number of apartments available and many landlords cut back on maintence and improvements. While some families are able to rent an apartment more cheaply and/or avoid rent increases the shortage of apartments increases. Given the increased ability to choose between potential renters, allegations of discrimination increase.
   3. The government raises the tax on gasoline by $2.00 a gallon reducing a current budget deficit. People begin to cut back on driving, bicycle sales and carpooling increase.
   4. The government declares pot and cocaine illegal. The price of illegal drugs increases causing an increase in supply as the incentive to sell drugs has increased. Gangs and gang violence increase as fewer people consume street drugs. Increase in drug arrests impacts the court and prison systems.
   5. The government prohibits the killing of wolves. The wolf population increases. Sheep and cattle herds suffer losses and reports of wolves in residential areas increase.
   6. The government bans the importation of sugar from South America. South American sugar beet growers cannot repay loans to American banks and turn to other more profitable crops such as coca leaves and marijuana. U.S. Sugar beet growers avoid a financial crisis as competition from the foreign producers declines.
   7. The government significantly increases capital gains taxes and personal income taxes on the top 20% of wage earners in the country. Income inequality declines and government tax revenue increases in the short term. Businesses report a decrease in investment capital and start up companies have difficulty attracting investors. Fewer new companies are started creating fewer job opportunities. Stock market activity decreases and the revenue from capital gains starts to decline.

Part 3 – Short answer questions:

1. Is air scarce? Is clean air scarce?
2. What is the opportunity cost of saving some of your paycheck?
3. Why is there a trade -off between equality and efficiency?
4. Water is a need but diamonds are only a want. Is the marginal benefit of an additional glass of water greater or lesser than that of an additional one carat diamond? Why?
5. Your car needs to be repaired. You have already paid $500 to have the transmission fixed, but it still does not work properly. You can see your car “as is”: for $2,000. If your car were fixed, it would sell for $2,500. Your car can be fixed with a guarantee for another $300.00. Should you repair your car? Why?
6. Why do you think air bags have reduced deaths from auto crashes less than we had hoped?
7. Suppose one country is better at producing agricultural products because their soil is more fertile while another country is better at producing manufactured goods because they have skilled workers. If each country produced their specialty and traded, would there be more or less total output than if each country produced and attempted to satisfy their own agricultural and manufacturing needs and wants?
8. In Wealth of Nations, Adam Smith said “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regards to their own interests”. What do you think he meant?
9. If we save more and use it to build more physical capital, productivity will rise and we will have rising standard of living in the future. What is the opportunity cost of future growth?
10. Why is there still an opportunity cost when purchasing items on credit? What is the benefit of such purchases and why do offers of such credit increase the incentive to make purchases?
11. If the government printed twice as much money, what do you think would happen to prices and output if the economy was already producing at maximum capacity?
12. A goal for a society is to distribute resources more equally and fairly. How might you distribute resources if everyone was equally talented and worked equally hard? What if people had different talents and some people worked hard while others did not.
13. Who is more self-interested, the buyer or the seller?

Part 4 - True or False

\_\_\_\_\_54. When the government redistributes income with taxes and social program spending, the economy becomes more efficient?

\_\_\_\_\_55. When economists say that “There ain’t no such thing as a free lunch” they mean that all economic decisions involve trade offs and opportunity cost.

\_\_\_\_\_56. Adam Smith’s “invisible hand” concept describes how corporate business reaches into the pockets of consumers like an “invisible hand”.

\_\_\_\_\_57. Workers in the United States have a relatively high standard of living because the United States has a high minimum wage.

\_\_\_\_\_58. To a student, the opportunity cost of going to a basketball game would include the price of the ticket and the value of the time that could have been spent studying.

\_\_\_\_\_59. An individual farmer is likely to have market power in the market for wheat.

\_\_\_\_\_60. Microsoft is an example of a company with market power.

\_\_\_\_\_61. In the short run, a reduction in inflation tends to cause a reduction in unemployment.

\_\_\_\_\_62. High and persistent inflation is cause by excessive growth in the quantity of money in the economy.

\_\_\_\_\_63. When a jet flies overhead, the noise that it generates is an externality.

\_\_\_\_\_64. Rational people act only when the marginal benefit of a decision exceeds the marginal cost.

\_\_\_\_\_65. The United States will benefit economically if we eliminate trade with Asian countries because we will be forced to produce more of our own manufactured products.

\_\_\_\_\_66. A tax on liquor raises the price of liquor and provides an incentive for consumers to drink more.

\_\_\_\_\_67. An unintended consequence of public support for higher education is that low tuition provides an incentive for many people to attend state universities even if they have no desire to learn anything.

\_\_\_\_\_68. Price if the best means of assigning values and determining how scare resources and products should be allocated.

\_\_\_\_\_69. Sue is better at cleaning and Bob is better at cooking. If each specializes in what they are best at the tasks will be completed quicker and more efficiently.

\_\_\_\_\_70. Buying a mattress on credit with no payments for three years reduces the over-all opportunity cost of this purchase.

\_\_\_\_\_71. The concept of sunk cost can explain why people sometimes stay in bad relationships.

Part 5- Additional Critical Thinking

72. Suppose a university decides to lower the cost of parking on campus by reducing the price of a parking permit from $200 to just $5 per semester.

a. What do you think will happen to the number of students desiring to park their cars on campus?

b. What will happen to the amount of time it takes the average student to find a parking place?

c. Thinking in terms of opportunity cost, would the lower price of a parking permit necessarily lower the true cost of parking?

d. Would the opportunity cost of parking be the same for students with no outside employment and students with jobs starting at $15.00 per hour?

73. Use opportunity cost to explain why a women with a college education employed as an attorney is less likely to have a child than a woman with no education and who is illegally in the country.